UNIVERSITY OF MAINE SYSTEM
Board of Trustees

Investment Committee

March 11, 2019
University of Maine System – Executive Offices
Rudman Conference Room, 253 Estabrooke Hall, Orono

Present: Committee Members: Kelly Martin, Chair, Mark Gardner (by phone), Karl Turner (at USM), James Erwin (at USM), and Trevor Hustus (at USM). **Non-Voting, Non Trustee Committee Members:** Robert Blackwood (at USM), Peter Handy (at USM), and Erik Hayward (at USM). **Staff:** Tracy Elliott, Ryan Low (at UMA), David Demers (at UMA), and Ellen Doughty **Others:** Jay Roney – NEPC (by phone), Kelly Regan – NEPC, Michael Pratico – CAPTRUST (by phone), and Anne Devine – MMA (at USM).

Absent: James Donnelly.

Trustee Martin, Chair, called the meeting to order and welcomed everyone.

Contributory Retirement Plans – Investment Advisory Services Contract Extension.
Through a competitive procurement process, UMS engaged CAPTRUST Financial Advisors (CAPTRUST) to perform investment advisory services commencing January 2, 2013. The contract allowed for a set 7-year period with three 1-year extensions. The contract is currently in its seventh year and management recommends that the Investment Committee approve the extension of CAPTRUST for calendar year 2020.

This extension would be based on the terms of the Request for Proposal (RFP) issued in 2012 and CAPTRUST's pricing provided in 2012. CAPTRUST fees are $97,329 for calendar year 2019 and the contract allows for a CPI-U based annual increase capped at 5% annually for a maximum annual fee for calendar year 2020 of $102,195.

Action Taken:
On a motion by Trustee Turner, which was seconded by Trustee Gardner, the Investment Committee approved the following resolution:

> The Board of Trustees, acting through the Investment Committee, approved the extension of CAPTRUST's appointment as the University of Maine System's investment advisers for the Contributory Retirement Plans for calendar year 2020.

Asset Allocation Review.

Kelly Regan and Jay Roney, with New England Pension Consultants (NEPC), provided a summary outlook of the markets noting that market dynamics shifted significantly in 2018, disrupting many of their key market themes. They believe we have entered a late-cycle market environment and are likely to see a higher volatility regime, which offers more risk but also tactical opportunities.

NEPC reviewed the asset allocation recommendations for all three portfolios (Managed Investment Pool, Pension Fund and Operating Fund) with the following highlights.

Operating Fund. NEPC reviewed the current policy asset allocation and recommended two changes to improve the yield of the portfolio as well as reduce the portfolio's tracking error to a policy benchmark. Given the yield curve and current cash rates, NEPC recommended eliminating the Treasury Inflation Protected Securities allocation (5%) and re-allocating the funds to cash (money market funds). Additionally, NEPC recommended reducing the global asset allocation target from 12.5% to 8.0% with a 2.5% re-allocation to core bonds and 2% allocation to global equity. The expected risk/return metrics over an intermediate time period (5-7 years) is expected to remain the same, but NEPC believes the new allocation will improve short-term results. NEPC will work with System Staff on a rebalancing plan given these changes as well as the large operating cash inflow received in January.

Managed Investment Pool (MIP). NEPC discussed the MIP's recent performance and noted that asset allocation was a benefit to performance; however, asset allocation deviations and manager selection have detracted from performance over the one to seven year time period. With this in mind, NEPC recommended three changes to improve the portfolio's liquidity, reduce fees and maintain a similar risk/return posture. First, NEPC recommended reducing global asset allocation from 23% to 15% with a 5% increase to equities and a 3% increase to fixed income. Second, NEPC recommended shortening the duration of the Treasury Inflation Protected Securities (TIPS) allocation by adding the Vanguard Short-Term Inflation Protected Securities Index Fund (VTSPX). Third, NEPC recommended eliminating the targets to private equity (2%) and private real assets (3%) consistent with Committee recommendation and the BOT's vote at its January 28, 2019 meeting to make no additional investment in Private Equity. The allocation would be placed in equity. The two current investments in these allocations (Hancock Timber and Landmark) will take some time to fully distribute capital and it is expected that the portfolio will underweight equities until these positions liquidate. The expected risk/return metrics over an intermediate time period (5-7 years) is expected to remain the same, but NEPC believes the new allocation will improve short-term results, improve daily liquidity and fees. NEPC will work with System Staff on a rebalancing plan given these changes.

At the upcoming meetings, NEPC will work with the Investment Committee to re-affirm or find replacements to those managers that have underperformed over the intermediate term.

Defined Benefit Pension Fund. NEPC noted the characteristics of the Pension Fund, which is in the payout phase with 18% of the portfolio currently disbursed for benefits annually. As such, this portfolio has a very conservative asset allocation given expectations for future benefit payments highlighting the importance of liquidity, downside protection and low fees. As a result, NEPC recommended three asset allocation changes to improve liquidity, reduce portfolio fees and simplify the portfolio. The first recommendation was to collapse large cap equity, small cap equity and international equity into an equity mandate that incorporates all of those asset classes. NEPC recommended that the Committee consider a passive equity allocation with a fund recommendation to be brought forward at the next meeting. Following Committee discussion, it was determined that NEPC will bring forward both active and passive managers for the mandate. The second recommendation was to reduce global asset allocation from 27.5% to 8% with the funds re-allocated to equity (11.5%) and fixed income (8%). Lastly, NEPC recommended shortening the duration of the Treasury Inflation Protected Securities (TIPS) allocation by adding the Vanguard Short-Term Inflation Protected Securities Index Fund (VTAPX). However, NEPC will work with Vanguard to see if the Pension Fund can access the same share class ticker as the MIP. The expected risk/return metrics over an intermediate time period (5-7 years) is expected to remain the same, but NEPC believes the new allocation will improve short-term results, improve daily liquidity and fees. NEPC will work with System Staff on a rebalancing plan given these changes.

Action Taken:
On a motion by Trustee Turner, which was seconded by Trustee Gardner, the Investment Committee approved the following resolution as amended:

The Board of Trustees, acting through the Investment Committee, approved the following asset allocation recommendations.

Operating Fund

1. Reduce global asset allocation from 12.5% to 8% and re-allocate funds to traditional equity (2%) and fixed income (2.5%)
2. Eliminate TIPS allocation and re-allocation to liquidity pool (cash)

Managed Investment Pool

1. Reduce global asset allocation from 23% to 15% and re-allocate to traditional equity (5%) and fixed income (3%)
2. Eliminate private markets targets (5%) and allocate to equity: Investment Committee previously voted to not allocate additional funds to private markets
3. Diversify Treasury Inflation Protected Securities (TIPS) allocation: Add Vanguard Short-Term Inflation Protected Securities Index Fund, VTSPX (3.5% allocation)

Pension Fund

1. Collapse large cap equity, small cap equity and international equity into a global equity index or actively managed product (TBD),
2. Reduce global asset allocation from 27.5% to 8% and re-allocate to traditional equity (11.5%) and fixed income (8%)
3. Diversify Treasury Inflation Protected Securities (TIPS) allocation: Add Vanguard Short-Term Inflation Protected Securities Index Fund, VTAPX (3.5% allocation)

NEPC Portfolio Performance Reviews.
Kelly Regan and Jay Roney of NEPC provided a brief performance review for all three portfolios for the quarter ended December 31, 2018, with the following highlights:

Managed Investment Pool (MIP):
The Managed Investment Pool (MIP) returned -6.8% calendar year ending December 31, 2018. During the calendar year, managers detracted 70 basis points of value. However, during the fourth quarter 2018, strategies including conservative global asset allocation strategies and the emerging market equity managers added significant value to the portfolio in a down market environment.

Defined Benefit Pension Fund:
The Pension Fund returned -3.3% calendar year ending December 31, 2018. During the calendar year, managers added 20 basis points of value. During the fourth quarter 2018 strategies including conservative global asset allocation strategies and the emerging market equity managers added significant value to the portfolio in a down market environment equating to 100 basis points of value add in the fourth quarter.

Operating Cash Fund:
The Operating Fund returned -0.2% calendar year ending December 31, 2018. The Operating Fund had a nice return in a very difficult market environment given the very conservative risk profile of the

Fund which held up well due to the sizable allocation to the liquidity pool. Managers detracted 20 basis points of value during this time period. Most managers were ahead or in-line with their stated benchmarks and the main detractor was a select global asset allocation manager and absolute return fixed income. This portfolio should expect higher returns in the future as interest rates and bond yields have risen.

FY2020 Endowment Spending Rate.

At its December 20, 2018 meeting, the Investment Committee reviewed and approved the recommended fiscal year 2020 (FY20) endowment spending rate of 4.5%. Tracy Elliott, Vice President of Finance and Controller, reviewed the estimated spending that this approved rate will support in FY20. An estimated $4.2 million is expected for endowed spending and $1.1 million for a management fee. An estimated $250 thousand will be reinvested to rebuild those endowments that are underwater.

Defined Contribution Plans Review.

Michael Pratico, Senior Vice President, with CAPTRUST Financial Advisors, provided a brief market commentary and a quarterly overview of plan investments.

Mr. Pratico noted that most asset classes fell in the fourth quarter, adding a negative tinge to 2018’s already lackluster results. Concerns included slowing growth in the U.S. and abroad, rising U.S. interest rates, and uncertainty driven by trade tensions, political turmoil, and recession fears. U.S. stocks fell sharply in the fourth quarter, erasing year-to-date gains, while international stocks posted double-digit losses in the fourth quarter and for the year. Bonds closed out the year flat.

The Committee and its advisor reviewed all funds consistent with the process outlined in the Investment Policy Statement. All funds, with one exception, are currently “in good standing” based on CAPTRUST’s scoring methodology.

Mr. Pratico highlighted the following:

Effective January 14, 2019: Goldman Sachs Mid Cap Growth (GGOUX) will be removed and replaced with MFS Mid Cap Growth Fund (OTCKX). Oppenheimer International Growth Fund (OIGIX) will be removed and replaced with American Funds Europacific Growth Fund (RERGX). Participant assets will map accordingly.

Vanguard Target Date funds slightly underperformed for the quarter based on a pull-back in International Equity and Emerging Markets as well as better performance from US equites. Vanguard’s current positioning is slightly underweight US and overweight international and emerging markets. The Vanguard Target Date funds remain amongst the highest scoring funds based on CAPTRUST methodology.

Carillon Eagle Small Cap Growth was marked for review scoring a 78. The strategy’s second quarter 2018 and year to date results were in the bottom quartile of the peer group and lagged the benchmark. Notably, the strategy is coming off a solid 2017 in which it landed in the top half of the peer group and outperformed the benchmark. Second quarter underperformance was primarily driven by negative stock selection in technology, industrials and financials. CAPTRUST continues to recommend the strategy.

For participants looking for a largely actively managed Global Equity fund, CREF Stock continues to be an appropriate choice. The fund is well diversified across several asset classes and has expenses well below industry averages.

TIAA Real Estate – Real Estate provides additional diversification for participants and the TIAA Real Estate fund offers a unique ability to invest directly in real estate as opposed to traditional REIT funds. CAPTRUST and the Committee continue to believe TIAA Real Estate is an appropriate option within a participant choice retirement plan.

CAPTRUST recommended moving to the Vanguard Target Date Institutional share class based on the Plan recently crossing the $100 million threshold which qualifies UMS for this lower priced share class.

Action Taken:
On a motion by Trustee Hustus, which was seconded by Trustee Turner, the Investment Committee approved moving from the Vanguard Target Retirement Investor share class to the lower fee Vanguard Target Retirement Institutional share class.

Adjournment

Tracy Elliott for
Ellen N. Doughty, Clerk